

Responsibilities  
of  
Directors of Cooperatives

By  
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I am not an attorney and the comments contained herein are not directed toward the solution of any specific legal problem. In the event a special legal question arises in areas discussed in this paper, advice should be sought from the cooperative's attorney knowledgeable of cooperative law.

Boards of directors vary in structure, composition, behavior, economic outlook, size, competency and in many other ways. No board of directors is identical to another. They have different objectives, values and basic beliefs, ethics and the individual board members have different philosophical ideals and behaviors.

Foremost among the responsibilities of directors of cooperatives is to be knowledgeable of and understand cooperatives as one of the four ways of doing business in our free competitive economy. Cooperatives are a unique form of business and directors and managers must capitalize on this uniqueness. Society has established special rules for each of the ways of doing business in our economy. Cooperatives have special rules to follow and cooperative directors must be knowledgeable of them.

A cooperative is a business enterprise but at the same time is an extension of the member's personal business. A cooperative is a unique type of business that is organized, owned, and controlled by people who have joined together voluntarily in a contractual arrangement to provide themselves needed supplies and/or services. The margins or losses incurred by this unique form of business belong to the user as they represent an overcharge or underpayment to users. Directors assume a fiduciary responsibility to see that the users' funds are protected and returned to them as patronage refunds.

John W. Holt, Director, Corporation Tax Division, Internal Revenue Service, wrote that "The cooperative is acting as a type of conduit in doing the patrons' business, and that the cooperative's transaction is really the patron's transaction. This places the cooperative in an agency, trust, fiduciary or conduit role, however one cares to try and define the relationship. The fact and theory merge in that the cooperative is not entitled to entity ownership of the results of the business. These results belong to the patrons on the basis of their patronage, a pre-existing legal obligation. Thus, we do not have a separate taxable organization carrying on a 'for profit business' that we should tax apart from its ownership."

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Most agricultural cooperatives are chartered under state laws and operates under the same Federal and State business laws and regulations as other firms. (Banks for Cooperatives, Federal Land Banks, Production Credit Associations, and Federal Savings and Loan Associations have Federal Charters.) Directors and Managers must be knowledgeable of the statute under which the cooperative is incorporated, the cooperatives Articles of Incorporation, Bylaws, and Policies.

Managers and Directors of cooperatives have a responsibility to know, understand and educate employees, members and the public about the three basic principles that distinguish cooperatives from other types of business in our free competitive economy.

1. Operations at Cost.

Savings (or net margins) above costs of operation or losses incurred belong to the users not the cooperative.

2. Democratic Control

Many cooperatives operate on a one member one vote basis. However, about 25% of the states permit cooperatives to be organized that allocate a limited number of votes according to the volume of business done by the member with the cooperative.

3. Limited Return on Equity Capital

Federal and State laws specify maximum interest rates of usually 8%. This basic principle prevents the allocation of savings or margins to investors and tends to insure that users will receive the margins generated by their cooperative.

The second responsibility of Directors and Manager of Cooperatives is to have a philosophy of "What's best for farmers rather than what's best for me."

WHAT ARE YOU TRYING TO DO?

Directors must know the objective of the business. The objective is the intended goal of the cooperative and gives direction to Directors, Management, Employees and Members. When directors, management, employees and members have the same objective for the cooperative, they can all aim their efforts and resources at a single target, thus eliminating uncertain directives and interpersonal conflicts. With the firm's objective clearly identified and communicated, the efforts of all concerned can be propelled and motivated with the greatest velocity and accuracy.

THE BOARD OF DIRECTORS

Each board of directors has a wide latitude in how it functions and how it organizes its resources to achieve its specific objectives.

Management of corporations often determine how much information a board of directors may receive as well as on what subjects it may receive information. The agenda of the board meeting may be influenced by what the chief executive officer wishes the board to know.

Boards of directors have come under sharp criticism in recent years from stockholders, professional board watchers, consumer advocates and government agencies. Too often those evaluating or criticising boards tend to believe that all boards of directors are identical groups and should function identically. When a particular board fails to fit into the common mold this causes confusion and increases the criticism of the particular board.

To understand responsibilities of directors of cooperatives we need to find the answers to the following questions: What are boards of directors? Why do they exist? What management function do they serve? How are they organized? How do they interface with stockholders, the chief executive officer? What legal rights and obligations do boards have? What economic, social and political influence affects their deliberations and decisions?

Stockholders or members of a cooperative corporation have neither the responsibility nor the right to take part in corporate management. Stockholders or members' rights are to elect those persons who they feel are most qualified to serve as the organization's governing group or body and then to control their performance. The governing group of U. S. commercial corporations is known as the Board of Directors. In some non-commercial organizations the governing board is known as the Board of Trustees.

In the United States the corporation is usually the creation of state government, (with the exception of those organizations that hold federal charters such as Federal Savings and Loan Associations, Production Credit, Federal Land Bank Associations and Banks for Cooperatives). The corporation is a legal entity whose affairs must be managed and that responsibility is vested in a board of directors. The laws permitting the chartering of corporations are very specific and the corporation has no legal existence unless a board of directors is designated on the charter application. The board of directors may share its management responsibility by delegating to those that hires to manage the operation of the corporation.

A corporation's board of directors is elected by the corporation's stockholders or members. The board of directors is the persons who are given the power to manage the corporation. This power comes from the corporate charter and the corporation's stockholders.

In some corporations the board of directors run the corporation with an iron hand. In others, the board provides only minimum guidance.

Some people believe the board has one main task: to select a president. After that, it should keep its hands off corporate management and leave it to the president. On the other hand, some people believe the board should play an active role in managing the corporation. Such a board meets more often and is more involved in managing the corporation. The iron hand and hands offs approaches are extremes. There are, however, many positions in between.

In many corporations the board concentrates on developing long-range goals and long-range plans. Board members do not get involved in the day-to-day management. The board sets the objectives and goals, establishes policies and the officers and employees manage the corporation to achieve the goals.

Board members have certain legal obligations. They must function in the best interest of the owners. They also must be reasonable and prudent in doing their job. They must be careful in managing the corporation's affairs as they are in managing their personal affairs. The board also must oversee and evaluate the job being done by the officers and employees. Beyond these basic legal obligations, opinions vary on the extent of the board's role in corporate management.

#### DIRECTOR DEFINED

"A director is one who sits on a Board of Directors of a company or corporation and who has the legal responsibility of exercising control over the officers and affairs of the company or corporation." 2/

"A director has a fiduciary duty to the corporation and to its stockholders to manage the affairs of the corporation in a manner which is consistent with their interests. Any breach of this fiduciary duty may subject him to personal liability to both shareholders and the corporation." 3/

Fiduciary is defined as "a person having a duty created by his undertaking to act primarily for the benefit of another in matters connected with his undertaking--in the nature of a position of trust or holding confidence." 4/

When a member of a cooperative is elected by his fellow members to a position on the Board of Directors he faces a two-fold challenge:

- (1) To represent all stockholders or members of the cooperative, not just himself or only the members of his district but the total membership.
- (2) He is vested by law with the responsibility to reasonably conduct the affairs of the business for the welfare of the cooperative.

This dual responsibility exists because the corporation is an association of shareholders or members created under law and regarded as an artificial person by the courts, "having a legal entity entirely separate and distinct from the individuals who compose it, with the capacity of continuous existence or succession, and having the capacity as such legal entity, of taking, holding and conveying property, suing and being sued, and the exercising of such other powers as may be conferred on it by law just as a natural person may."

This two-fold challenge to the farmer director of a cooperative is compounded and made more difficult as cooperative directors are elected democratically by members in their district. As director of the cooperative, they must base their actions on what's best for the cooperative, not on what's best for themselves or their neighbors.

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2/ Law Directory, Steven Gefets, page 60.

3/ Ibid.

4/ Ibid., page 83.

The Board of Directors is not only charged with the responsibility for exercising all the authority of the corporation, its management, the safeguarding of the cooperative's assets and the conduct of its business--the Board of Directors is in fact the only group of persons in whom this authority is vested.

The acceptance of an obligation by an individual to serve as a director of his cooperative implies that he recognizes and accepts responsibility of the position, the specific responsibilities set forth in the state statute and in the cooperative's bylaws, and he agrees to discharge these responsibilities to the best of his ability.

The Board of Directors is the governing body of a corporation legally created under state statutes and issued a "charter." The state statutes give the Board authority to exercise all the powers of the corporation limited only by any conditions set forth in the chartering states statute and the corporation's bylaws.

Your state statute that permits the incorporation of cooperatives sets forth your responsibility by stating "The affairs of the Association shall be managed by a Board of not less than five directors, elected by the members of stockholders from their own number."5/

The directors of cooperatives are charged with the management of the total corporation and are responsible for the acts of the principle executive officers of the corporation.

Directors are responsible for the operation of the cooperative within the provisions of the law, the Bylaws, membership and marketing agreement of the cooperative, plus all the regulations of agencies such as OSHA, EPA, SEC, IRS, etc.

The Board of Directors is the governing body of a corporation. The ultimate authority for the management of a corporation rests with the owners. The method of government of a corporation is in the nature representative and is in some respects analogous to the representative democracy with which we are familiar in the government of the United States. Members of the Board of Directors are elected by the shareholders or members and these Boards elect the officers of the corporation.6/

The Board of Directors is the policy-determining body of the corporation and is also the body which either generally or specifically authorizes business transactions. Boards of Directors are analogous to Congress.

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5/ Chapter 1729.13, Ohio Revised Code. Section 17-1611 Kansas Corporation Statute. Chapter 8, Article 5748, Texas Revised Statutes.

6/ Anderson's Ohio Corporate Desk Book, page 4.

It is well established in corporate law that the corporation can act only through its Board of Directors except in the unusual situation where stockholders act by unanimous vote at a meeting and the Board of Directors subsequently ratifies the action.

#### BOARD ACTS AS A GROUP

It must always be remembered that the Board of Directors' decisions are group decisions. The Board is a group; it acts jointly as a Board. It never acts as an individual. Opinions and actions result from the contributions of all the persons making up the Board. The actions of a Board of Directors are conditioned by the background, experience, knowledge, and attitude of its collective membership. In fact, it is the abilities and the application of these abilities of the men who make up the Board of Directors that is the real decisive factor in the growth and accomplishments of any firm.

To discharge their responsibilities, directors must make certain that all their actions are within the powers conferred upon them by laws of the state in which the cooperative is incorporated, the corporation's charter, bylaws, and marketing or membership contracts.

#### A BOARD MEMBER'S POSITION IS ONE OF TRUSTEESHIP

It is difficult to define all the duties of the Board of Directors. In general, it can be said that members of the Board of Directors are individually and collectively under a continuing obligation to exercise their best judgement and apply such knowledge and experience as they have in the conduct and management of the cooperative's business. Directors must use good faith and exercise the care which is commonly exercised by an ordinarily careful and prudent man under similar conditions. They must have in mind that they are trustees charged with the responsibility of dealing with the rights and properties of others.

Members of the cooperative elect a director to a position of trusteeship. In effect, members legally place their financial interests in the cooperative in the hands of the elected director.

The law says that directors must not take advantage of their position as director to gain profit or benefit for themselves at the expense of the cooperative. While some may interpret this to mean that a director should not receive special consideration in his dealings with the management of his cooperative, it now seems this responsibility as a director extends into the competitive economy in which his cooperative operates. To some this means the cooperative director who accepts special price or service consideration not offered to all farmers by competitors of his cooperative may have a conflict of interest.

## BYLAWS-GUIDELINES FOR DIRECTORS

Directors must use care in directing the affairs of the cooperative to keep within the powers conferred upon them by the corporation's charter, bylaws, marketing contracts, if any, and the laws of the State. If the directors exceed their authority, neglect their responsibilities or act in violation of the provisions of the statute, their charter, bylaws, or marketing contracts, legal liability could result.

Bylaws are the rules that the membership has adopted for directors to follow in their operation of the firm. Bylaws perform the same function for a director that a blueprint performs for a builder. The power to adopt bylaws resides in the stockholders or members, and they alone have the power to adopt them. Bylaws are the instructions by the owners to the directors as to how the cooperative is to be operated.

The members of a corporation and its directors and officers usually are conclusively presumed to have notice of bylaws, and of what they contain and hence they are bound to them, although, as a fact they may be ignorant of them. It is advisable that directors make available to each member of the corporation a copy of the bylaws.

Legal liabilities may result from a failure of officers and directors to observe bylaws. The directors as well as the managers are in law simply agents, and agents are bound by the instruction of their principles.

## CO-OP DIRECTOR SPECIAL

It is important that cooperative directors understand that their position as a director of their cooperative differs from that of a director for other types of business. Directors of non-cooperatives are usually the principle owners of the firm, and they may serve not only as a director of their firm but also serve as one of the executives, such as the general manager. The director of a cooperative is elected democratically without regard to his investment in the cooperative. In fact, the total investment of the president of a cooperative may be one share of membership stock. The cooperative's ownership is not controlled by the Board of Directors as the general corporation.

The director of a cooperative must recognize that, except when the Board is in formal meeting, his authority is equal only to the rights and authority of any individual member of the cooperative. This applies to each director of a cooperative regardless of position he may hold on the Board.

As individuals, the members of the Board of Directors of a cooperative have no authority to act for, or bind the corporation, unless they are duly elected or appointed to do so in legal meeting of the Board of Directors. Cooperatives are unique, they are people; people working together. It is the responsibility of directors to capitalize on the uniqueness of cooperatives.

## DIRECTORS TELL MEMBERS AND PUBLIC ABOUT THE COOPERATIVE

The cooperative director must recognize that he is responsible for the image of his cooperative.

He must be convinced of the value of the cooperative to himself, his neighbors, and to society in general, or he should not have accepted the responsibilities of director. Consequently, he is responsible for developing an accurate understanding in the community of the cooperative's objectives, policies, principles, and benefits. He is responsible for presenting the facts about the cooperative association to the public and for correcting any erroneous ideas people may have about the cooperative.

A cooperative director cannot be satisfied just to wait to be asked about the cooperative; he will seek opportunities to promote it.

By his loyalty to and enthusiasm for his cooperative, he sets an example for the entire membership.

As a rule directors discharge their responsibilities in three ways:

1. They handle their responsibilities directly as a board. They deliberate, make decisions, and give instructions as a unit--not as individuals.
2. They delegate duties to a competent manager.
3. They tell members and the public about the co-op.

## POLICIES--A TOOL FOR EFFECTIVE COOPERATIVE DIRECTORS

Current policies are necessary for the employees, manager and board of directors of a cooperative to work together to serve their members.

For a board of directors of a cooperative to effectively discharge its responsibilities, it should be devoting a large portion of each board meeting to policy formulation, policy evaluation and policy implication. Successful cooperative managers formulate policies for the day-to-day operation of the cooperative that will guide all employees in making decisions within the limits of the policies established by the board of directors.

Policies are statements in general terms which give direction to plans and operations. Some boards of directors are kept so busy reacting to situations that they never have time to develop policies to give direction to their co-operatives and thus these directors may never really be in control of their cooperatives.

The law under which cooperatives are incorporated gives the authority to manage the cooperative firm to the board of directors. The board usually delegates some of their authority to a manager. Even if the board of directors passes the authority for policy formulation on to hired management, the elected



board of directors is still responsible for the policies under which the cooperative operates.

#### FINANCIAL STABILITY OF THE COOPERATIVE

Directors have the responsibility to safeguard the financial structure of the cooperative. Directors must request, study and use all financial reports necessary to make sound and prudent decisions. Some cooperative directors prefer to have reports such as monthly statements delivered to them in advance of the meeting in order that they may study them and understand them. Such a practice has merit and directors who receive the important information about their cooperative must protect its confidential value.

Directors have the responsibility of determining the ratio of debt to equity capital. This policy is directly related to the IRS tax classification the directors choose for their cooperative.

The percentage of patronage returned to patrons in the form of cash is a responsibility of directors and can have an important bearing on the cash flow and stock redemption plans.

Directors must approve new members and should establish a policy to give direction to the receiving applications and approving of new members. A membership application form is a valuable tool to; first set forth the requirements for membership in the cooperative and outline the member's responsibilities to the cooperative.

The stock redemption plan, interest dividends and source of debt capital are all responsibilities of the board.

It is the board's responsibility to secure an audit, receive the audit report from the auditor and to report to the membership.

Boards have the responsibility to approve the annual budget for the cooperative and to follow the activities of the cooperative to insure the budget is followed.

The board should hold a regular (monthly) executive session as a part of their board meeting and the President must report to the manager immediately following the executive session any concerns of the board.

#### DISCHARGING RESPONSIBILITIES AS A BOARD

When discharging their responsibilities directly as a board, directors deliberate, ask questions, make decisions, and give instructions as a unit, not as individual board members. The following are some of the responsibilities the cooperative directors ordinarily handle directly as a board:

1. Take his position as director seriously and prepare himself to discharge his responsibilities in a professional manner.

2. Establish the objectives, consider and act on the policies, programs, budgets, and other management controls needed to direct the administration of the cooperative's affairs, and assure desired results.
3. Control and preserve the rights and conserve the assets, and exercise all the corporate powers of the corporation.
4. Select, fix the compensation, designate the responsibilities, and delegate to the general manager and regional boards, authority commensurate with the results for which they are held responsible with responsibilities set forth in a job description for boards and management.
5. Review periodic analysis of members' needs and direct whatever long-range forecasting and planning activities are necessary to assure that all phases of the organizations' operations are adequately equipped to meet members' needs most effectively.
6. Maintain continuous control over the association's activities through the consideration and review of periodic reports, analysis, and statistics submitted by the general manager and the treasurer; compare the current position with the requirements of approved goals, programs and budgets; effect remedial action through the general manager whenever the need is indicated.
7. Consider the act on the membership applications recommended by the management and enforce existing membership contracts.
8. Assure that members' complaints and suggestions are sympathetically considered, that members are kept adequately informed of the affairs of the association, and that sound relationships, understanding, and communication are maintained between the management and members.
9. Have made annually an audit of the fiscal affairs of the association by an outside independent auditor, employed and reporting directly to the board.
10. Distribute cooperative's earnings.
11. Make long-range plans.
12. Devote the necessary time preparation for participation in board meetings.
13. Attend board meetings regularly.
14. Act in good faith and with reasonable care and prudence in handling the business and affairs of the cooperative.
15. Discharge their fiduciary responsibilities to their cooperative and the cooperative member.
16. Regularly hold an executive session of the board and entire board report immediately its concerns and actions to management.

17. Prepare and maintain manual of board policies.

#### DELEGATION TO HIRED MANAGEMENT

While the Board of Directors is charged by law with the responsibility of managing the affairs of a business, this responsibility should not be interpreted as meaning the Board should manage the day-to-day operating details of the cooperative. The day-to-day management should be delegated to a competent general manager who is held accountable by the Board for his decisions and performance. The Board is responsible for directing the manager in conducting the cooperative affairs.

The Board of Directors can delegate all operational responsibility and authority to a general manager, but the Board of Directors retains the accountability.

The manager has the responsibility of mastering the uniqueness of a cooperative as one of the four ways of doing business in our free competitive economy.

Due to the uniqueness of the responsibilities of the cooperative director, the cooperative manager will usually assume responsibilities not assumed by managers of other types of business. Directors are usually full time farmers and do not have the time or staff of a professional director. The cooperative manager must, if agreeable with the board members, do much of the research, figuring and writing to prepare board members to discharge their responsibilities with dispatch.

The manager may write suggested policies for board discussion and approval or disapproval. The manager may be called upon to prepare the budget and submit it to the board with all the pro and con facts and complete data to permit directors to have complete understanding of it before approval.

The manager will need to provide complete and understandable monthly or periodically financial statements in order that board members can know at all times the financial condition of the cooperative and its operation in relation to the approved budget.

The manager must provide for the education of employees of the cooperative about cooperatives as one of the four ways of doing business in our competitive economy.

Other duties of the Cooperative Managers are:

- Inform employees, members and the public of the cooperative's policies.
- Prepare job descriptions for all positions and staff the cooperative with capable employees within the employment policy of the cooperative.
- Operate the cooperative within the law, regulations and board policies.
- To make recommendations to the board.

Basically the Manager decides HOW it is to be done.

It is important that all board members of the cooperative and the manager have the same understanding of who is responsible. The following exercise has proved a valuable tool to reaching a common understanding.

Determine who is responsible and in the blank indicated, who you think has the responsibility. Use D for Director, M for Manager, and S for Stockholder or member.

- \_\_\_\_\_ 1. To hold the annual election of directors.
- \_\_\_\_\_ 2. To employ an auditor.
- \_\_\_\_\_ 3. To provide for indemnification of directors.
- \_\_\_\_\_ 4. To hire employees.
- \_\_\_\_\_ 5. To give the bookkeeper a raise.
- \_\_\_\_\_ 6. To determine the tax status of the cooperative.
- \_\_\_\_\_ 7. Where the cooperative will buy its supplies.
- \_\_\_\_\_ 8. When to redeem patronage refunds.
- \_\_\_\_\_ 9. To change the name of the cooperative.
- \_\_\_\_\_ 10. Where the cooperative will borrow money.
- \_\_\_\_\_ 11. To merge with another cooperative.
- \_\_\_\_\_ 12. That all members are qualified for membership.
- \_\_\_\_\_ 13. That only members vote.
- \_\_\_\_\_ 14. That each member has a copy of the bylaws.
- \_\_\_\_\_ 15. That the auditor and manager prepare reports that are clear and  
and understandable to all board members.
- \_\_\_\_\_ 16. To approve director's expense accounts.

Team work depends upon each player knowing the rules of the game, how the game is to be played and what his responsibilities and duties are--and then for each player to discharge his responsibilities with dispatch. What's best for farmers versus what's best for me is a theme that can guide both boards and managers. A periodic review of the cooperative's objectives and goals can help to insure we are all working for the same results. Educating employees and members about cooperatives as a way of doing business can also improve the skills of boards and managers. Job descriptions that are well prepared, discussed and used can insure all positions are well staffed. Policies that are written, discussed, used and kept current can build confidence in members, employees, and board members. Each board must do these things for themselves.